No. 82-1766

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

A. G. BECKER INCORPORATED,
Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR A. G. BECKER INCORPORATED

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The Respondents' brief confirms that the majority decision below should be reversed.

ARGUMENT

1. At issue here is the lower court's holding (J.A. 228; 693 F.2d at 141 [1]) that the Federal Reserve Board may "adapt" the flat prohibitions of the Glass-Steagall Act to the Board's subjective notions of "current business reality" and "the changing financial needs of our economy." The Board understandably does not attempt to defend that ruling, presumably because it flies in the face of this Court's repeated holdings to the contrary.[2] Instead, the Board's brief simply ignores it.

Nor does the Board deny that, both at the time the Glass-Steagall Act was adopted and repeatedly thereafter, Congress refused to vest in the Board not only the *precise* rulemaking power the Board has arrogated to itself in this case, but *any* rulemaking power at all.[3] This Court has repeatedly held that the judiciary may not confer legislative power upon an administrative agency that Congress has chosen to withhold.[4]

Nor has the Board offered any convincing explanation why its startling concession—that the plain language of the Glass-

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[1] References to the Joint Appendix and to the parties are the same as in our opening brief. References to A. G. Becker's opening brief are cited as "AGB Br. ." References to the Federal Reserve Board's answering brief are cited as "FRB Br. ." References to the brief *amicus curiae* filed by Goldman, Sachs & Co. are cited as "GS Am. Br. ," and references to the reply brief of the SIA are cited as "SIA Reply Br. ."

[2] *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971) (*"Camp"*); *Board of Governors of the Federal Reserve System* v. *Investment Company Institute*, 450 U.S. 56 (1981) (*"Board of Governors"*).

[3] In 1933, Congress considered permitting commercial banks to engage in the securities business under a system of ongoing federal supervision and *ad hoc* administrative regulation, but rejected that alternative in favor of the prophylactic remedy of absolute prohibition (AGB Br. 11-16). Congress has steadfastly adhered to its initial policy choice ever since, expressly refusing, in 1935, to amend the Act to permit banks "under regulation by the Comptroller of the Currency, to underwrite and sell bonds, debentures, and notes" (AGB Br. at 14), and expressly forbidding the Comptroller, in 1980, to issue any regulations concerning "securities activities of National Banks under the Act commonly known as the 'Glass-Steagall Act.' " *Id.*

[4] *See, e.g., Pacific Gas & Electric Co.* v. *State Energy Resources Commission*, 103 S.Ct. 1713, 1730 (1983); *Baldridge* v. *Shapiro*, 455 U.S. 345, 358 (1982).

Steagall Act flatly prohibits banks from engaging in the very activity the Board sought to authorize here (J.A. 131)—should not dispose of this case.[5] Both this Term and last, this Court has confirmed the wisdom of precluding administrative agencies from asserting long dormant and unexercised rule-making "authority" belatedly "discovered" to excuse conduct inconsistent with the plain language of the agencies' enabling legislation.[6]

In attempting to justify its refusal to adhere to the plain meaning of the Glass-Steagall Act, the Board now argues only that Congress could not possibly have intended to do what Congress in fact did—prohibit banks from underwriting corporate commercial paper "notes." Even though Congress, in terms, prohibited banks from underwriting any "notes," a term Congress intentionally used broadly, the Board asserts that Congress really must have intended to prohibit banks from underwriting only *those* "notes used to raise capital for an extended period of time as part of a corporation's permanent financial structure," and not what the Board seeks to characterize as "short-term," "risk-free," "commercial" notes (FRB Br. at 15-32).

But, as we explain below, the Board's amorphous "functional analysis" has no basis in law, clashes with economic reality, and would establish *ad hoc* regulation and constant litigation as the primary method of determining whether, when and under what circumstances heretofore Congressionally-prohibited bank securities activities may become permissible by administrative fiat. For all these reasons, the Board's ruling and guidelines are contrary to law and should be set aside.

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[5] The Board's counsel now seeks to reverse field and argue that, perhaps, the Board's unambiguous concession about the plain language of the Glass-Steagall Act was too generous (FRB Br. at 22). It is the Board's position in its ruling, of course, and not the post-hoc rationalization of its counsel, by which the Board's conduct must be judged. *See, e.g., Camp, supra,* 401 U.S. at 627. In any event, concession or not, the plain language of the Glass-Steagall Act prohibits banks from underwriting commercial paper. *See* AGB Br. at 24-29; SIA Reply Br.

[6] *See BATF* v. *FLRA,* 104 S.Ct. 439 (1983); *BankAmerica Corp.* v. *United States,* 103 S.Ct. 2266 (1983); *Motor Vehicle Manufacturers Ass'n* v. *State Farm Mutual Automobile Insurance Co.,* 103 S.Ct. 2856 (1983). *See also, INS* v. *Chadha,* 103 S.Ct. 2764 (1983).

2. Recognizing that its functional analysis is without legal foundation unless the analysis is mandated by statute, the Board claims (FRB Br. 23) that the Glass-Steagall Act itself *compels* the Board to "adapt" the Act to "the changing financial needs of our economy." Because Section 21 prohibits banks from selling "stocks, bonds, debentures, notes, or other securities," and because Section 21 does not expressly define the term "notes," the Board insists that "the statutory text" somehow "directs" the Board to examine all "notes," *on a case-by-case basis,* in order "to determine whether [they] share[ ] that characteristic of an investment that is the common feature of each of the other enumerated instruments" (FRB Br. at 23). According to the Board, Congress intended Section 21 to forbid commercial banks to underwrite only those "notes" which the Board finds to possess that "common feature."

The " 'short answer' " to this argument, of course, " 'is that Congress did not write the statute that way.' " [7] Apart from the fact that Section 21 is not even addressed to the Board, the text of Section 21 neither "directs" the Board to redraft the statutory language nor confers upon the Board the rulemaking authority required to do so. Rather, Section 21 simply but forcefully "directs" commercial banks to refrain from engaging *"to any extent whatever"* in the underwriting of five separate types of financial instruments, one of which is "notes." *See* 12 U.S.C. § 378(a)(1) (emphasis supplied).[8]

But, even if it were assumed that the language of Section 21 *sub silentio* directs the Board to engage in some sort of

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[7] *Russello* v. *United States,* 104 S.Ct. 296, 300 (1983) *(quoting United States* v. *Naftalin,* 441 U.S. 768, 783 (1979)).

[8] The Board's brief belatedly suggests (FRB Br. at 12) that Section 21 should not be deemed to apply to banks at all. That suggestion, of course, was rejected by the Board itself (J.A. 131), is inconsistent with the plain language of Section 21, and twice has been expressly rejected by this Court. *See Board of Governors, supra,* 450 U.S. at 58 n.24; *Camp, supra,* 401 U.S. at 639.

comparative inquiry, the Board's brief is unable to identify "that characteristic of an investment that is the common feature" of "stocks," "bonds," and "debentures":

- the common feature cannot be the form in which the investor receives the return on his investment (FRB Br. at 21), since Section 21 includes securities which pay their return in the form of profits ("stock") and securities which pay their return in the form of interest ("bonds" and "debentures");
- the common characteristic also cannot be the maturity of the security (FRB Br. at 21), because "stock" has no maturity at all, while "bonds" and "debentures" abound in all varieties of maturities; [9]
- the common feature cannot be the existence of a trust indenture (FRB Br. at 21-22), since stock is not issued under a trust indenture, and
- the common feature cannot be registration under the federal securities laws (FRB Br. at 22), because many bonds and debentures never are registered under the federal securities laws.[10]

In truth, the only common feature shared by "stocks, bonds, debentures, notes, or other securities" is that Congress flatly has forbidden banks to underwrite them all "to any extent whatever." *See* 12 U.S.C. § 378(a)(1).

As a result, Congress' failure expressly to define the term "notes" hardly establishes that Congress intended to authorize the Board to abandon the plain statutory language in favor of a functional analysis. Rather, as the Court reiterated just this Term, "[t]his silence compels us to 'start with the assumption that the legislative purpose is expressed by the ordinary meaning of the words used.' " [11] Because the plain and ordinary meaning of the statutory term "notes" encompasses commercial

[9] Indeed, "bonds" and "debentures" with maturities identical to those of commercial paper are widely marketed today, just as they were at the time the Glass-Steagall Act was enacted (AGB Br. at 38 n.65 & Supp. App.).

[10] *See* 15 U.S.C. § 77c(a)(2).

[11] *Russello* v. *United States, supra,* 104 S.Ct. at 300 (*quoting Richards* v. *United States,* 369 U.S. 1, 9 (1962)). *See also, Perrin* v. *United States,* 444 U.S. 37, 42 (1979).

paper, as the Board itself concedes (J.A. 131),[12] that plain statutory language is "conclusive" under the controlling decisions of the Court.[13]

3. Even if it were assumed, *arguendo,* that Congress intended to permit the Board to "adapt" the plain language of the Glass-Steagall Act to "the changing financial needs of our economy" through the application of a standardless functional analysis, the "functional analysis" applied by the Board here is completely inadequate for the task. Whatever revisionist theories one is willing to indulge, there is no basis for assuming that Congress authorized the Board to ignore economic reality, or to promote increased litigation to test whether specific bank activities are permissible or impermissible.

a. Since Congress indisputably enacted the Glass-Steagall Act to insulate commercial banks from the conflicts of interest and other dangers that arise when commercial banks engage in the securities underwriting business,[14] the only functional analysis of commercial paper that could possibly be reconciled with the basic statutory purpose is one which focuses on the function commercial paper serves for the *underwriting bank,* not for the *issuer* of the paper. (*See* AGB Br. at 38-40). When a commercial bank, like Bankers Trust, underwrites commercial paper, it does not purchase commercial paper as part of its traditional lending function, but rather, it engages in the promotional investment banking function of *marketing* commercial paper to investors. *See Camp, supra,* 401 U.S. at 635-38.[15] Proper application of a functional analysis thus confirms

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[12] That Congress intended its words to be given their plain meaning was reaffirmed shortly after the passage of the Act, when Congress, in 1935, itself amended Section 21 to except "mortgage notes" from the statutory bar (AGB Br. at 27-28).

[13] *Board of Governors, supra,* 450 U.S. at 65; *Camp, supra,* 401 U.S. at 639. *Accord,* Comment, 9 Jour. Corp. L. 321, 331-32 (1984) (*"JCL Comment"*); Comment, *Glass-Steagall: A Proposal For Regulation Rather Than Prohibition,* 47 Alb. L. Rev. 1379, 1392 n.79, 1402 (1983) (*"Glass-Steagall: A Proposal For Regulation"*).

[14] *Board of Governors, supra,* 450 U.S. at 61-62; *Camp, supra,* 401 U.S. at 630-34.

[15] *Accord,* Orbe, *Glass-Steagall: Lest We Forget,* 11 Fla. St. L. Rev. 163, 195 (1983) (*"Orbe"*) ("The commercial bank's basic business is lending and the investment bank's basic business is marketing").

that banks which underwrite commercial paper are engaging in the *marketing* of "notes or other securities," an activity flatly prohibited by the Glass-Steagall Act. *Id.* at 639.[16]

b. The Board's functional analysis also ignores economic reality. Thus, the Board asserts that banks may underwrite commercial paper because these notes constitute the functional equivalent of a bank "loan," which the Board defines as "a *short-term* extension of credit to a business to finance *short-term* needs" (FRB Br. at 34) (emphasis supplied). But, it takes no special expertise to observe that banks today frequently make long-term loans for the aquisition of fixed assets and for permanent increases in working capital, just as they did in the period prior to the passage of the Glass-Steagall Act (GS Am Br. at 17-19).[17]

Moreover, commercial paper plainly is not the equivalent of a bank loan, even on the Board's terms. Thus, for example, although the Board claims that commercial paper is the functional equivalent of a corporate bank loan because the two instruments possess similar maturities (FRB Br. at 35), the Board's own data unmistakably refute this claim and document the frequently gross disparity in their maturities.[18] Equally mistaken are the Board's claims (FRB Br. at 36-37) that

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[16] *Accord,* (J.A. 251; 693 F.2d at 152) (Robb, J. dissenting); *JCL Comment, supra,* at 336; Note, 52 U. Cinn. L. Rev. 618, 633 (1983) ("*Cincinnati Note*") ("[I]t is the promotional role of the bank that is the critical distinction [and] that brings the bank's sale of third party commercial paper within the aegis of [*Camp*] and the prohibitions of Glass-Steagall").

[17] *See* (J.A. 252; 693 F.2d at 151) (Robb, J., dissenting). *Accord,* D. Hayes, *Bank Lending Policies* 89, 107, 109 (2d ed. 1977); G. Munn, *Encylopedia of Banking and Finance* 892 (7th ed. 1973); *Business Loans of American Commercial Banks* chs. 7, 9 (B. Beckhart ed. 1959).

[18] *Compare* 67 Fed. Res. Bull. A26 (Dec. 1981) (average maturity of commercial bank loans is 29.6 months) *with* FRB Br. at 35 (average maturity of commercial paper underwritten by Bankers Trust is 60 days).

commercial paper notes, like corporate bank loans, are issued only in large denominations,[19] and are sold only to institutional investors.[20]

Similarly, there is no basis for the Board's assertion (FRB Br. at 36) that commercial paper and corporate bank loans are customarily used for the same purposes—current, self-liquidating transactions. As the very study endorsed by the Board demonstrates, during periods of tight monetary policy or volatile interest rates, companies which would normally finance their capital expenditures with *long term* debt often turn to commercial paper to avoid committing themselves to high rate financing for extended periods of time.[21]

Finally, the Board's assertion (FRB Br. at 35) that commercial paper resembles a corporate bank loan because there is no secondary market for commercial paper is misplaced. One need look no further than the record in this case, which documents that Bankers Trust itself makes purchases "in the secondary market" of paper it has underwritten for an issuer (J.A. 33) when the original purchaser of the paper has an unexpected need for cash, and that Bankers Trust purchases commercial paper "in the secondary market" on behalf of its parent holding company (J.A. 55).

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[19] Commercial paper actually is sold in denominations as low as $5,000. *JCL Comment, supra,* at 340 n.151; Lowenstein, *The Commercial Paper Market and the Federal Securities Laws,* 4 Corp. L. Rev. 128, 142 (1981) *("Lowenstein").*

[20] As this Court is aware, commercial paper often is sold to individual investors, *see John Nuveen & Co.* v. *Sanders,* 425 U.S. 929 (1976), *vacating and remanding,* 524 F.2d 1064 (7th Cir. 1975). Indeed, Bankers Trust has touted its ability to sell commercial paper to individual "retail" investors as a primary advantage of the bank's commercial paper underwriting services (J.A. 41).

[21] Hurley, *The Commercial Paper Market Since the Mid-Seventies,* 68 Fed. Res. Bull. 327, 329 (June 1982). *See* Comment, *The Commercial Paper Market and the Securities Acts,* 39 U. Chi. L. Rev. 362, 374, 389 (1972); Davidson, *Liquidity Patterns in Corporate Financing,* Monthly Rev. Fed. Res. Bank Richmond (May 1971), at 2, 3; Schadrack & Breimyer, *Recent Developments in the Commercial Paper Market,* Monthly Rev. Fed. Res. Bank N.Y., 280, 283-86 (Dec. 1970); Snellings, *The Federal Reserve System and the Commercial Paper Market,* J. Comm. Bank Lending, Feb., 1971 at 14, 16. *See also, Lowenstein, supra,* at 128; Dun's Review, *The Case for Commercial Paper,* June, 1968 at 28. *See generally,* GS Am. Br. at 18-21.

c. Acceptance of the Board's functional analysis will result in the piecemeal dismantling of the Act's flat prohibitions. If the Board can equate commercial paper with a corporate bank loan merely because the purchaser of the paper effectively functions as a lender by extending funds to the issuer (FRB Br. at 37-38), then other debt securities, such as bonds, debentures, and "investment notes," could also be deemed the equivalent of a commercial bank loan. This rationale, however,

> would * * * sweep into its coverage almost all devices used by businesses to raise capital—including stocks and bonds—transforming transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks.

(J.A. 217; 519 F.Supp. at 615). *Accord, Glass-Steagall: A Proposal For Regulation, supra,* at 1392-93.[22]

d. The Board's functional analysis, if accepted, would institutionalize litigation as the primary determinant of the scope of permissible bank securities activities. *Orbe, supra,* at 189; *Cincinnati Note, supra,* at 635. For example, the Board asserts, and the majority below held, that although the commercial paper at issue here is not a Glass-Steagall Act "security," it may become one if it is "marketed widely" (J.A. 192), is issued in "small[ ] denominations," or is sold "to the general public" (J.A. 250; 693 F.2d at 151).

But, because the Board and the majority never defined the terms "widely marketed," "small[ ] denominations," or "general public," the only manner in which their meaning can be

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[22] Although the Board now seeks to avoid this conundrum by asserting that the Glass-Steagall Act permits banks to underwrite only those notes which possess the "cluster" of features possessed by the commercial paper at issue here (FRB Br. at 34 n.60), the recent actions of the federal banking regulators prove that they are adept at stretching the Act even further. *See* CCH Fed. Bank L. Rep. (Current), ¶ 85,432 (1983) (ruling of the Comptroller of the Currency authorizing the mass-marketing by banks of $3,000 interests in notes to unsophisticated individual investors). Moreover, since the Board's "cluster" rationale has no statutory antecedent, those who create the "law" would remain free to "adapt" it to suit their own notions of "the changing financial needs of our economy."

determined is through a series of administrative and judicial proceedings designed "functionally" to "analyze" the facts of each particular case. This process must then be repeated whenever the Board decides to "adapt" its "adaptations" of the Act to meet changing business conditions, or whenever an issue of statutory coverage arises with respect to any instrument of corporate finance.

e. The Board finally argues that its decision to "adapt" the Glass-Steagall Act to "current business reality" is appropriate because, regardless of the plain statutory language or Congress' structural prohibition, the Board believes that bank underwriting of commercial paper will not give rise to the conflicts of interest, financial dangers and other potential abuses Congress intended the Glass-Steagall Act to eliminate (FRB Br. at 40-44). This argument fails for two simple, but fundamental, reasons.

First. As this Court has twice held, Congress enacted the Glass-Steagall Act to exclude commercial banks "completely" and "entirely" from the securities underwriting business because *Congress* determined that bank securities activities necessarily give rise to *"potential"* hazards. *See Board of Governors, supra,* 450 U.S. at 62; *Camp, supra,* 401 U.S. at 635, 639 (emphasis supplied). Since Congress did not authorize the federal banking regulators to override its considered legislative judgment, or to exempt any particular securities activity from the Act's flat prohibition based upon the regulators' assessment of the *actual* dangers involved, the Board's claims of safety, even if they were true, are wholly irrelevant.

Second. The Board's present claims of safety are entitled to no weight since the Board opined earlier in this proceeding that *"the Board is concerned about possible unsafe or unsound practices that would be involved in Bankers Trust's commercial paper activities and in similar activities by any other state member bank"* (J.A. 146) (emphasis supplied). The question posed here, therefore, is not *whether* the hazards the Glass-Steagall Act was designed to prevent are present when banks

underwrite commercial paper—the Board has already conceded that point.

Rather, the question posed here is whether the Board may authorize, under a system of administrative regulation, those activities that Congress has flatly prohibited to banks.[23] Because Congress, in enacting the statute fifty years ago, itself decided that this sort of regulatory approach is inadequate to safeguard against the pervasive and "subtle" hazards Congress feared [24]—a decision Congress has since reaffirmed—the answer to that question plainly is no.[25]

* * * *

The majority opinion below is an anomaly in an otherwise consistent course of judicial interpretations of the Glass-Steagall Act. Its acceptance of the Board's unauthorized assertion of rulemaking power, in the stead of the statute's flat prohibitions, eradicates the critical distinctions and principled methodology that Congress itself embodied in the plain statutory language. Consequently, the decision below will serve as an open invitation to commercial banks to test the regulatory environment by offering products and services flatly prohibited under the

[23] The Board's *post*-litigation posture should be juxtaposed with the Board's *pre*-litigation pronouncement that, in light of the Board's conclusion that commercial paper does not constitute "notes or other securities," it "does not appear necessary to examine the dangers that the Act was intended to eliminate" (J.A. 140). Post-hoc claims of safety, such as those offered here by the Board, are entitled to no deference at all from the courts, and have been expressly rejected by this Court. *See Camp, supra,* 401 U.S. at 628.

[24] *See* 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley); *see also, Camp, supra,* 401 U.S. at 630.

[25] *See Board of Governors of the Federal Reserve System* v. *Agnew,* 329 U.S. 441, 449 (1947) (The Glass-Steagall Act "is a preventive and prophylactic measure"). *Accord, Glass-Steagall: A Proposal For Regulation, supra,* at 1381 ("[N]either the judiciary nor the bank administrative agencies possess any flexibility in applying the Act's * * * restrictions"). In any event, bank underwriting of commercial paper, even under the Board's guidelines, continues to pose the dangers Congress intended the Glass-Steagall Act to eliminate. *See* SIA Reply Br.; *Cincinnati Note, supra,* at 635 ("[T]he Board's guidelines do not begin to eliminate the 'subtle hazards' " involved in bank commercial paper activities).

Glass-Steagall Act. Such a "sell now—litigate later" philosophy can only undermine Congress' structural prohibitions and foment copious litigation.

In sum, the task of "adapt[ing]" the Glass-Steagall Act to the "changing financial needs of our economy" is not one that belongs to the bureaucracy or even to the courts. That task properly lies in the province of Congress, and Congress alone.

CONCLUSION

For each and all of the reasons set forth above and in A. G. Becker's initial brief, the majority opinion below should be reversed, and the Board's ruling and guidelines should be declared null and void.

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